

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Goldberg, et al. Analyst: LuAnna Hass Bill Number: AB 205  
Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: January 28, 2003  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Filing Status/Domestic Partners

### SUMMARY

This bill would allow domestic partners to file personal income tax returns as either 1) married filing joint, or 2) married filing separate.

In addition, this bill would make changes to various California laws regarding domestic partners, including the creation of community property rights. These changes do not affect the department and are not discussed in this analysis.

### PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to eliminate discrimination by giving domestic partners the same rights and benefits as married persons.

### EFFECTIVE/OPERATIVE DATE

If enacted during the 2003 legislative session, this bill would be effective January 1, 2004. This bill states that the income tax provision would be operative January 1, 2005.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

Existing federal and state tax laws provide guidelines for determining a taxpayer's filing status when filing an income tax return. For example, federal law states a husband and wife can file a joint income tax return even though one of the spouses has no gross income or deductions, except in the following cases:

- One of the spouses was a nonresident alien at some time during the taxable year;
- The spouses have different taxable years, subject to exceptions; and
- Where one or both spouses died during the taxable year, subject to exceptions.

Board Position:

_____ S	_____ NA	_____ NP
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_____ N	_____ OUA	_____ <u>X</u> PENDING

Department Director  
Gerald H. Goldberg

Date  
4/11/03

Subject to limitations, an individual who files a separate tax return for a taxable year where a joint return could have been filed may subsequently file a joint return with their spouse for that same taxable year.

For purposes of state income tax law, adjusted gross income (AGI) is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, minus specific deductions. For purposes of computing limitations based upon AGI, such as miscellaneous itemized deductions where only the portion that exceeds 2% of the AGI may be deducted, the taxpayer would use the AGI that is required to be shown on the federal tax return for the same taxable year.

Generally, under state law an individual must use the same filing status for their California income tax return that was used on their federal income tax return filed for the same taxable year. If the Franchise Tax Board (FTB) determines that the taxpayer's federal filing status was incorrect, FTB may revise the state return to reflect the correct filing status. A husband and wife may file separate returns if, during the taxable year, either spouse was an active member of the armed forces or a nonresident with no California income. Otherwise, a spouse may not file a separate return for any taxable year where a joint return has already been filed after the filing period for either spouse to file a separate return has expired. In addition, no joint return can be made if the husband and wife have different taxable years, subject to exception. State tax law also provides guidelines for determining a taxpayer's filing status in the event of the death of one or both spouses. Subject to limitations, an individual who files a separate tax return for a taxable year where a joint return could have been filed may subsequently file a joint return with their spouse for that same taxable year.

Under federal and state income tax law, spouses who file a joint tax return are each responsible for the accuracy of the return and for the full tax liability for that tax year. These obligations apply regardless of which spouse earns the income. The concept of obligating each spouse separately for all of the tax liability reflected on the joint return is called joint and several liability. Under certain circumstances individuals who file joint returns may be eligible for relief from joint and several liability.

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions. These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. In addition, state law provides general rules that apply to the division of credits among two or more taxpayers, such as a husband and wife or partners in a business. State law also provides that any credit limitation applies at both the entity and individual taxpayer level, unless otherwise specified.

The terms taxpayer, individual, person, husband, and wife, and the determination of marital status are defined within the state income tax law. In addition, the term domestic partner is defined by reference to Family Code Section 297, which states that California recognizes a domestic partnership as being established when specified requirements are met. State tax law provides that the taxpayer's domestic partner be treated as the spouse of the taxpayer for purposes of determining various tax benefits relating to medical expenses, such as:

- medical expenses deductible as an itemized deduction,
- medical expenses deductible as an adjustment to gross income for self-employed individual health insurance,
- an exclusion from gross income for employer-provided accident and health insurance,
- an exclusion from gross income for medical expense reimbursement if the expense was not previously deducted, and
- long-term health care insurance deductible as a medical expense.

State law, under the Family Code, defines marriage as a personal relation that arises out of a civil contract between a man and a woman. All real or personal property, wherever situated, that is acquired by a married person during the marriage while living in California is considered community property.

### THIS BILL

Under state income tax law, this bill would allow registered domestic partners to file a personal income tax return jointly or separately by applying the standards applicable to married couples under federal income tax law. In addition, this bill would add domestic partners to current law provisions regarding filing status as follows:

- Subject to exception, a spouse or domestic partner may not file a separate return for any taxable year where a joint return has already been filed after the filing period for either spouse or domestic partner to file a separate return has expired.
- No joint return can be made if the domestic partners have different taxable years, subject to exception.
- Guidelines are provided for determining a taxpayer's filing status in the event of the death of one or both domestic partners.

In addition, this bill would give registered domestic partners the same community property rights that are granted to and imposed upon spouses in a civil marriage.

Essentially, depending on the incomes earned by the domestic partners, the provision of the bill relating to income tax would have varying impacts on income taxes for domestic partners. Please see Appendix A for examples using varying income amounts.

In addition, this provision could change the filing requirement for some domestic partners. Without regard to marital or domestic partner status, for 2002 a single individual with no dependents is required to file an income tax return if their California gross income exceeds \$12,080. Similarly, those who file married filing jointly are required to combine their income and file a return if their total California gross income exceeds \$24,160. For example, domestic partners where only one partner has a filing requirement (income exceeds \$12,080), would be required under this bill to combine their incomes so the domestic partners would file as married, either joint or separate. As a result, these same partners would not have an income tax filing requirement if their combined income were more than \$12,080 but less than \$24,160.

### IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update. However, the department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- As stated under "State/Federal Law" above, for purposes of computing limitations based upon AGI, the taxpayer would use the AGI that is required to be shown on the federal tax return for the same taxable year. Therefore, federal AGI determines, among other tax items, the 2% floor on itemized deductions, the AGI floor on medical expenses, the state percentage of the federal child and dependent care credit, and the phase out of exemption credits. Since domestic partners would be required to file separate federal tax returns, it is unclear what the federal AGI figure would be in order to compute the limitations.

- California personal income tax returns use the federal AGI to begin the calculation of state income tax. Since domestic partners would file separate federal tax returns, it is unclear what the federal AGI figure would be for domestic partners filing jointly on the state tax return.
- The department uses automated systems to compare taxpayer return information to files received from other state and federal agencies, including the Internal Revenue Service (IRS). This automated systems search through IRS records by Social Security Number and name and compares information on the taxpayer's federal income tax return to the information on the California income tax return. Since current law generally requires the filing status of the taxpayer for the state tax return to be the same filing status as on the federal return, the systems have the ability to verify joint returns based on the primary taxpayer's information. Since domestic partners are required to file separate federal income tax returns and this bill would allow domestic partners to file a joint state income tax return, the department anticipates a significant delay in the ability of the automated systems to compare taxpayer information. The systems would be required to run through the federal information more than once as the systems search for the primary taxpayer and the secondary taxpayer individually because each taxpayer would have a separate return at the federal level. The systems would need additional programming and testing prior to being operational.
- A provision of this bill would create community property laws for domestic partners. It appears the intent of the author is to allow domestic partners to have the same community property privileges and burdens as those given to civil marriage partners. This general provision could be construed to allow domestic partners to be treated as joint owners for all provisions regarding income taxes, including division of income and credits. However, if this is the intent, department staff would recommend a clarifying amendment within the Revenue and Taxation Code to specify the exact provisions where domestic partners would be considered spouses. Department staff is available to work with the author's office to draft amendments to resolve this concern.

### TECHNICAL CONSIDERATIONS

The term "registered domestic partners" is undefined within the provision of the bill pertaining to the Revenue and Taxation Code. To ease administration, department staff suggests an amendment that would add a cross-reference to Family Code Section 297, which describes registered domestic partners. In addition, current income tax law requires spouses that file joint returns to be married as of the last day of the taxable year. For consistency purposes, department staff suggests an amendment that would require domestic partners to be registered by the last day of the taxable year. Amendment 1 is provided.

### **LEGISLATIVE HISTORY**

AB 25 (Migden, Stats. 2001, Ch. 893) allowed several existing taxpayer benefits for medical expenses and health insurance benefits to include a taxpayer's domestic partner and a domestic partner's dependents.

## OTHER STATES' INFORMATION

Few states have addressed tax concerns relating to same-sex marriages or domestic partners through legislation. Below are the findings for three states.

Vermont enacted a same-sex civil union law that provides eligible persons of the same sex with an established relationship all the same legal benefits, protections, and responsibilities under law that are granted to married couples. For state income tax purposes, the parties to a civil union may file a joint income tax return and will be taxed in the same manner as married persons.

Hawaii defines domestic partners as reciprocal beneficiaries. Those partners who are legally registered receive some of the same rights and benefits of marriage. State income tax law does not provide reciprocal beneficiaries with income tax benefits or allow joint income tax returns.

Massachusetts does not allow domestic partners to file joint income tax returns.

## FISCAL IMPACT

As discussed above under "Implementation Considerations," implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

The department anticipates customer service contacts from taxpayers seeking clarification of the filing requirements. Further, the automated systems that compare federal and state tax information for audit purposes would need additional programming and testing. As a result, the department would experience delays when the automated systems compare federal and state information because the systems would need to search the records individually to match both domestic partners. Departmental costs cannot be determined until implementation concerns have been resolved, but are anticipated to be significant.

## ECONOMIC IMPACT

### Revenue Estimate

This bill would result in revenue losses as follows:

Revenue Impact Beginning on or After January 1, 2005 (\$ Millions)			
Fiscal Year	2004-05	2005-06	2006-07
Revenue Loss	-1.0	-5.0	-7.5

Note: It is assumed for the second full fiscal year (2006-07) that there would be a significant increase in impact due to the incentive effect of potentially large tax savings for those households not currently registered.

This estimate reflects the current language of the bill that gives taxpayers the election to file jointly. This bill does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

### Revenue Discussion

There is no specific tax return data for registered domestic partners. However, a series of hypothetical examples were used to approximate the taxpayers that would significantly benefit by filing jointly (Appendix A). It appears domestic partners with a greater difference in incomes are more likely to benefit from filing jointly. In general, taxpayers with dependents and claiming Head of Household status would not benefit significantly.

As of January 2003, there were 18,368 registered domestic partnerships in California. Same-sex partnerships and opposite-sex partnerships in which one or both partners is at least age 62 and receiving Social Security benefits are included in the total number of registered partnerships. The number of registered domestic partnerships was reduced to 25% (18,400 times 0.25) to eliminate those households with dependents and those with domestic partners with comparable incomes. The resulting 4,600 partnerships represent those that would realize a tax savings by filing jointly. This result was multiplied by an average tax difference of \$1,000 (Appendix A), resulting in a revenue loss of approximately \$5.0 million for fiscal year 2005/2006.

For the second full fiscal year (2006-07), it is assumed that the impact would increase to approximately \$7.5 million. This is based on the increase in registered domestic partnerships from 7,100 in 2001 to 18,400 in 2003 following legislation to allow healthcare provisions to registered domestic partners. It is assumed that a similar incentive effect would occur if registered domestic partners anticipate significant tax savings. The 4,600 partnerships in the first fiscal year was increased by 60% to 7,400 partnerships. The result was multiplied by an average tax difference of \$1,000, resulting in a loss of approximately \$7.5 million.

Allowance was made for the disincentive effect of joint filing when each partner acquires joint liability for the return as filed and for those registered domestic partners who are opposite sex, at least 62 years of age and receiving Social Security benefits. Issues not dealt with in the hypothetical estimates, such as the renters credit or childcare credit, would have a minor additional impact.

### **ARGUMENTS/POLICY CONCERNS**

This bill states domestic partners may file either a joint return or file separately "by applying the standards applicable to married couples under federal income tax law." Since under federal law married persons (with narrow exceptions) are prohibited from filing as head of household or single, this bill could be construed to require domestic partners to file joint returns at the state level and no longer allow domestic partners to file single or married head of household returns at the state level. Although, this treatment would be consistent with married couples, domestic partners who currently file as head of household typically pay less income tax than if they were to file as married, filing jointly (See Appendix A).

This bill could have an impact on federal income tax law since those laws rely on each states' laws regarding married persons and their property. Currently, since California is a community property state, spouses who file separate federal income tax returns are required to split the incomes of each spouse to be claimed on each return. This bill would create community property laws for domestic partners that are similar to existing laws for civil marriage. Federal income tax law does not recognize domestic partners as married. However, since federal law relies on state laws regarding community property, domestic partners would be required to claim half of each others' income on their separate federal returns (single filing status). For example, under current federal law domestic partners with a filing requirement must file separate returns and pay the tax attributable to the individual returns. Assume Partner A has federal AGI of \$50,000 and Partner B has federal AGI of \$100,000. For the 2002 tax year, assuming each partner takes a standard deduction and one exemption, Partner A would have a tax of \$7,760, and Partner B would have a tax of \$22,013, for a total of **\$29,773**. Since the federal tax laws generally follow the state community property laws the domestic partners would continue to file individual federal returns. However, they would be required to split the community income of the partners. In the example above, Partner A would claim \$25,000 of his/her income and \$50,000 of Partner B's income. Partner B would do the same. Therefore, each partner would pay tax on an AGI of \$75,000. Again, assuming they each take a standard deduction and claim one exemption, each partner would pay \$14,510 in tax for a total of **\$29,020** for both partners. Therefore, depending on the individual circumstances of the taxpayer, this bill could result in domestic partners paying less federal income tax.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 205  
As Introduced January 28, 2003

AMENDMENT 1

On page 19, line 25, after "partners" insert:

, as described in Section 297 of the Family Code and who are registered as domestic partners as of the close of the taxable year,



## Appendix A

### Hypothetical Impacts Of Various Filing Statuses-2000 Tax Data

#### A. Taxpayers with equal incomes - \$25,000 to \$35,000

	Single Filer 1	Single Filer 2	Joint Filing Sum of 2 Singles	Single Filer 1	HOH Filer 2	Joint Filing Sum of 2 Singles
Income	\$35,000	\$35,000	\$70,000	\$35,000	\$35,000	\$70,000
Standard Deduction	2,800	2,800	5,622	2,800	5,622	5,622
Taxable Income	32,200	32,200	64,378	32,200	29,378	64,378
Tax Due	1,287	1,287	2,575	1,287	549	2,575
Personal Exemption One Dependent	75	75	150	75	75 235	150 235
Tax Liability	\$1,212	\$1,212	\$2,425	\$1,212	\$239	\$2,190

#### B. Taxpayers with disparate incomes - \$0 to \$25,000 and \$50,000 to \$75,000

	Single Filer 1	Single Filer 2	Joint Filing Sum of 2 Singles	Single Filer 1	HOH Filer 2	Joint Filing Sum of 2 Singles
Income	\$12,500	\$65,000	\$77,500	\$12,500	\$65,000	\$77,500
Total Deductions	2,636	8,887	11,523	2,636	11,783	14,419
Taxable Income	9,864	56,113	65,977	9,864	53,217	63,081
Tax Due	143	3,463	2,703	143	2,194	2,471
Personal Exemption One Dependent	75	75	150	75	75 235	150 235
Tax Liability	\$68	\$3,388	\$2,553	\$68	\$1,884	\$2,086

#### C. Taxpayers with one income - \$100,000

	Single Filer 1	Single Filer 2	Joint Filing Sum of 2 Singles
Income	\$0	\$100,000	\$100,000
Total Deductions	0	15,280	15,280
Taxable Income	0	84,720	84,720
Tax Due	0	6,123	4,368
Personal Exemption One Dependent	75	75	150
Tax Liability	\$0	\$6,048	\$4,218

D. Both taxpayers file as HOH - with higher incomes

	HOH Filer 1	HOH Filer 2	Joint Filing Sum of 2 Singles
Income	\$50,000	\$50,000	\$100,000
Total Deductions	7,457	7,457	15,280
Taxable Income	42,543	42,543	87,720
Tax Due	1,280	1,280	4,368
Personal Exemption	75	75	150
One Dependent	235	235	235
Tax Liability	\$970	\$970	\$3,983

E. Taxpayers with two incomes - \$35,000 and \$50,000

	Single Filer 1	Single Filer 2	Joint Filing Sum of 2 Singles
Income	\$35,000	\$50,000	\$85,000
Total Deductions	2,800	8,887	11,687
Taxable Income	32,200	41,113	73,313
Tax Due	1,287	2,068	3,308
Personal Exemption	75	75	150
One Dependent			
Tax Liability	\$1,212	\$1,993	\$3,158

Sources: Personal exemption, and dependent credits are from the "2001 California Tax Handbook".

Data are for the 2000 tax year.

- Average Standard Deductions are from the AGIC Resident tables for 2000.
- 2000 California Tax Tables from 2000 Package X.
- California Tax Tables for Joint filers was used for the combined tax liability.
- For B, the Standard Deduction was used for the lower income earner, and the average total deduction was used for the higher income earner.
- For C, the average total deduction was used for the single filer and the two HOH filers since they have higher incomes that would allow itemized deductions.